

# Confusion about entrepreneurship? Formal versus informal small businesses

A.A. Ligthelm

## ABSTRACT

A focus on supply-side economics and on factors determining economic growth is prominent in seeking sustainable solutions to sluggish international economic growth. There is renewed interest in entrepreneurship, business formation and growth. This paper is aimed at contrasting the growth performance and prospects of informal and formal small businesses, particularly the role of entrepreneurship in this regard. Descriptive and econometric modelling techniques are employed. In contrasting the entrepreneurial acumen embedded in small informal and formal business, it was found that innovative entrepreneurship represents the primary growth differentiator between these two business categories. The average informal business is established for survival, and its owner lacks natural entrepreneurial acumen, while small formal businesses show higher levels of growth instigated by an entrepreneurial spirit and mindset. The formal-to-informal business or entrepreneurship dichotomy creates a useful distinction for informing government policy choices. Small business support strategies should focus on businesses with embedded entrepreneurial acumen and hence the inherent dynamics to create and exploit new innovative economic opportunities resulting in the creation of employment opportunities and higher economic growth.

Key words: small business development, informal sector, business sustainability

---

Prof. A.A. Ligthelm is in the Bureau of Market Research, University of South Africa. Email: [Ligthaa@unisa.ac.za](mailto:Ligthaa@unisa.ac.za)

## Introduction

The 2008 world economic crisis, resulting in low economic growth and increasing unemployment, caused renewed interest in supply-side economics and in factors determining economic growth. Of particular importance in this regard is the interest in the study of entrepreneurship and business formation and growth. A wealth of research on this topic has recently emerged in the academic literature (Blackburn & Kovalainen 2009; Strom 2011; Zachary & Mishra 2011; Baumol 2011). In a study by Naude (2008), emphasis was placed on, *inter alia*, the importance of entrepreneurship for economic growth and the central role played by entrepreneurship in establishing businesses. This became even more prominent as the impact of the post-2008 government-induced macroeconomic stimulus measures started to wane and alternative sustainable long-term solutions were required. In 2011, the Obama Administration made the promotion of high growth and innovation-based entrepreneurship the core of the White House's National Innovation Strategy for achieving sustainable growth and quality jobs (Strom 2011).

Although the development of small, medium and micro enterprises (SMMEs) is one of the South African Government's priority programmes, the 2010 Global Entrepreneurship Monitor (GEM) survey confirmed below-average entrepreneurial and business activity in South Africa (Herrington, Kew & Kew 2010). This renewed emphasis on entrepreneurship and business development, coupled with South Africa's poor performance in this regard, confirms the need within both the public and private sectors for more information about the drivers of, and the barriers to, entrepreneurship and business development.

Within this discourse, the question of the role of the informal sector and its contribution to business growth and development is often raised. A five-year longitudinal study among a panel of informal businesses, as well as a study among small formal businesses in the same study area, reflects on this question.

This paper is aimed at contrasting the growth performance of informal and formal small businesses, particularly the role of entrepreneurship in business growth. The two business populations are located in exactly the same study area and are exposed to similar external environmental factors such as macroeconomic and sectoral conditions as well as structural changes in the study area. Differential business performance may therefore be attributed primarily to endogenous (internal) business factors and will be able to shed light on the following two research questions: what factors best explain differential growth performance between small informal and formal businesses and, secondly, whether the informal business sector can be regarded as a springboard for successful and productive business development and growth?

The following section of the paper briefly defines the informal sector and contextualises the different forms of entrepreneurship prior to presentation of the quantitative analysis.

### The informal sector in perspective

The lack of a shared view on the informal sector is largely related to the absence of a common view on the content and role of the informal sector, which has grown increasingly complex since it was first described in an International Labour Office (ILO) report on Kenya in 1972 (Tokman 2007).

Williams (2007) states that “for many years in western nations, the informal sector was represented as a largely negative realm and hindrance to development”. In contrast, in developing countries the informal sector has often been presented as a potential contributor to business development. The ILO (2002) holds the view that the informal sector acts as “an incubator for business potential and ... transitional base for accessibility and graduation to the formal economy”. The business acumen, creativity and innovation of informal business owners were presented as motivation for this view. In such a formal-to-informal dichotomy, the risk of over-simplification emerges while, ideally, a more textured understanding of the diverse and complex continuum of business establishments, ranging from micro-survivalists in the informal economy to sophisticated and innovative enterprises, is required. For the purposes of this study, the informal sector is collectively defined as small unregistered businesses operating as street vendors and in-home businesses established on residential sites (often termed ‘spaza shops’ or ‘tuck shops’ in South Africa). In contrast, small formal businesses are defined as businesses operating from fixed building structures located on business stands demarcated as such by local government (municipal) town-planning regulations.

### Entrepreneurship and business development

In studying the role of entrepreneurship and small business formation in economic development, it should be noted that not all forms of entrepreneurship and business formation are beneficial to economic growth and development. Baumol (1990) distinguishes the following entrepreneurial categories: productive, unproductive and even destructive (e.g. illegal activities). Productive entrepreneurship encompasses the exploitation of profitable opportunities with inherent growth prospects. Unproductive entrepreneurship is essentially business formation aimed at survival in a situation of unemployment and poverty and is particularly prevalent in the informal sector.

This distinction between productive and unproductive entrepreneurs closely resembles the Global Entrepreneurship Monitor (GEM) (Herrington et al. 2010) categories of entrepreneurs who pursue business opportunities (opportunity entrepreneurs) and those who are involved in entrepreneurial endeavours because they have no other choice of work (necessity entrepreneurs). Necessity entrepreneurs are strongly associated with the informal economy, representing a large percentage of economic activities in developing societies and countries (Schneider & Klinglmair 2004).

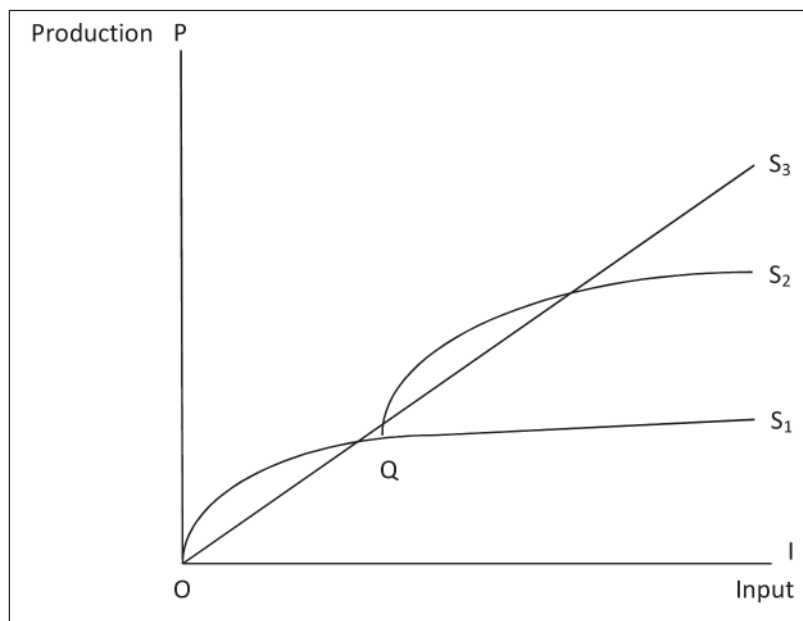
The potential contribution of informal/unproductive/necessity entrepreneurs towards economic growth and development is extensively debated in the literature. The consensus is aptly summarised by Berner, Gomez and Knorringer (2008). They stress that the motivation of unproductive entrepreneurship is not growth but survival, and serves primarily as a buffer against sinking deeper into poverty – its contribution to economic growth and development is marginal. Schramm (2004) confirms that policies aimed at promoting unproductive entrepreneurship are most often not successful. Banerjee and Duflo (2011) state that most informal businesses are established for survival. They argue that such entrepreneurs “do not have the talent, the skills or the appetite for risk needed to turn informal businesses into really successful businesses”. However, they also argue that informal businesses “still have an important role to play in the lives of the poor, because these tiny businesses will remain, perhaps for the foreseeable future, the only way many of the poor can manage to survive”.

In a microeconomic context, Figure 1 shows the production technology of the majority of informal businesses as well as the impact of entrepreneurial conduct in enhancing competitive advantage through improved inputs (e.g. technology and capital).  $OS_1$  reflects international as well as South African evidence on the production function of the majority of informal businesses. It shows a steep increase in production after business establishment but flattens very quickly, implying limited growth potential (Banerjee & Duflo 2011). This pattern suggests low overall returns despite high initial marginal returns. The production curve  $OS_3$  reflects the production technology of entrepreneurially endowed and growing businesses.

Developing societies are often endowed with large numbers of small informal businesses (often concentrated at transport intersections and adjacent to formal business centres) that are undifferentiated from other surrounding competitors. This results in many of these businesses remaining small with low overall returns. Elevating the production curve to  $QS_2$  requires entrepreneurial ingenuity. The fact that marginal returns are high should imply that it is possible to increase production

by allocating more resources to the business, but this does not happen. The answer to this dilemma is summarised by Banerjee and Duflo (2011) as follows:

Taken together, this evidence makes us seriously doubt the idea that the average small business owner (in the informal sector) is a natural 'entrepreneur', in the way we generally understand the term, meaning someone whose business has the potential to grow and who is able to take risks, work hard, and keep trying to make it happen...



Source: Adjusted from Banerjee & Duflo (2011)

Figure 1: The S-shape of entrepreneurship

The reality of differential production technology between informal and formal businesses, especially with regard to its nature, functioning and market position, requires revisiting the role of the informal sector entrepreneur in mainstream micro-theory and standard theoretical business models. This subject will be addressed in a follow-up paper.

## Measuring entrepreneurship

Examination of the role of entrepreneurship in small business survival and growth requires some measurement of the entrepreneurial acumen embedded in a business. Measurement is often conducted statistically at an aggregate level using the

occupational definition that describes entrepreneurs as the self-employed based on the notion that a person can be unemployed, self-employed or in wage employment. This approach allows an aggregate count of the number of self-employed (static measurement) or the rate of business start-ups (dynamic measurement) (Wennekers & Thurik 1999; Simrie, Herrington, Kew & Turton 2011; Naude 2008).

Measurement on the aggregate level does not portray the level and/or type of entrepreneurial acumen within an individual business. During the past almost four decades, a considerable body of research has emerged on the question of what differentiates an entrepreneur from a non-entrepreneur. Rather than exploring these extensive academic writings, this paper presents an introductory note that informs the basis of the approach followed in this study. In behavioural approaches, entrepreneurship is seen as a set of activities related to organisation (business) creation; while in trait approaches, an entrepreneur is depicted as a set of personality traits and characteristics (Gartner 1988, Llewellyn & Wilson 2003; Müller & Gappisch 2005). The approach followed in this article focuses on entrepreneurial actions rather than entrepreneurial character traits.

Organisational life-cycle theory suggests that any business proceeds through multiple stages, including birth, survival and growth, consolidation, diversification and ultimately decline and death (Hanks, Watson, Jansen & Chandler 1993; Cader & Leatherman 2011). Entrepreneurial actions are particularly relevant at the establishment/birth and survival/growth stages of the business life-cycle. The first stage of establishing a business is commonly known as the entrepreneurial phase. Chiang and Yan (2011) agree with this view, but also maintain that survival or growth is a distinct demanding entrepreneurial challenge. Innovative entrepreneurial actions are required to maintain and enhance the competitive advantages of the business, especially during its growth stage. Entrepreneurship is deemed an important factor that contributes to both business formation and the ultimate expansion or growth of the business. The entrepreneurial actions related to these business activities are analysed in this study. The differential application of these actions in the formal and informal business panels is of particular importance for this study.

Although entrepreneurial actions are determined by goals, plans and feedback, and planning is often regarded as a requirement for translating thoughts and intentions into actions, there is still controversy in entrepreneurship research on whether formal planning is useful (Frese et al. 2007). This is of particular importance for small businesses, as the majority of small businesses have simple systems and procedures allowing for flexible and short decision-making chains for quicker responses to customer needs (Singh, Garg & Deshmukh 2008). Allison, Chell and Hayes (2000) argue that entrepreneurs often base their decisions on intuition, while

Baker, Miner and Eesley (2003) state that planning makes entrepreneurs rigid, whereas the conditions for entrepreneurs are uncertain and require a high degree of improvisation. In this paper, both entrepreneurial actions translating from plans such as business, marketing and operational plans, as well as those that are merely intuitive, are implied.

Entrepreneurial actions are viewed as critical pathways to competitive advantage, improved performance and ultimately business growth (Kuratko, Ireland & Hornsby 2011). These include actions of creation, renewal and innovation. Porter (2008) argues that competition is pervasive and that every organisation needs a strategy to ensure the delivery of superior value to customers, especially in highly competitive environments. Innovative entrepreneurial actions focus on increased competitiveness and growth and are measured in this study by variables such as a future vision for the business, considering alternative investment and ease of venturing into business ventures.

## Data used in the analysis

Prior to introducing the two datasets used in the study, a brief background on the business structure of Soweto (where the surveys were conducted) is important to put the business environment in the study area in perspective. Soweto is the most prominent township area of South Africa with a population of approximately 1.5 million inhabitants and located adjacent to Johannesburg. Until the late-1990s, the township areas of South Africa were dominated by small informal businesses offering basic products and services. The majority of these businesses were informal and operated from residential homes and large informal markets adjacent to large transport intersections (bus and train stations, and taxi ranks). These informal businesses were supplemented by formal small businesses operating from demarcated business stands often clustered into relatively small shopping centres of between two and 20 small businesses.

Since the beginning of 2000, township areas including Soweto have experienced a restructuring of their business sector. This restructuring was largely activated by the expansion strategies of national retailers and franchisors, especially supermarket chains, establishing themselves in large newly erected shopping malls in these areas. This development was largely induced by significant strides in improving the living standards of inhabitants of township areas. Studies on economic class dynamics confirmed that the African middle class (township dwellers) has experienced significant gains in respect of improvement in social class and household income since 1998 (Ligthelm 2010: 132).

These adjustments in the economic structure of townships have created considerable pressure on the sustainability of small businesses. Although competition is one of society's most powerful forces to ensure effectiveness (Porter 2008), small businesses in townships (both formal and informal) have been exposed to substantial levels of competition (over a relatively short term) from large retail conglomerates and have had to adjust to ensure long-term sustainability. Notwithstanding this heightened level of competition experienced by small businesses, the business environment in Soweto is still well endowed with informal and formal small businesses.

The two datasets analysed in this study are representative of these two categories of small businesses: informal businesses operating mainly from kerbsides, transport intersections and residential homes, and formal businesses operating from demarcated business stands.

The data on informal businesses are extracted from a longitudinal study conducted among a panel of 350 informal businesses established in 2007. All businesses still in operation in subsequent years (2008–2011) were revisited and interviewed. The absence of a sample universe precluded a random sample selection. A judgemental sampling method was used in 2007 to ensure the inclusion of all informal businesses by sector and business type. The selection procedure was structured around five concentric circles in the area surrounding one of the newly developed malls to ensure an even spread of business respondents across the entire study area. The research instrument enquired about entrepreneurial and management actions performed by the informal business owners as well as other business dynamics such as growth, turnover and employment. For the purposes of this study, the total business panel as established in 2007, as well as the lifespan data collected over a period of five years (2007–2011), were analysed.

The longitudinal informal business study was succeeded in 2012 by a study among a panel of 650 formal small businesses in the same area. The realisation of the extremely low growth performance of the informal business sector over a period of five years motivated the shift of research focus to the small business sector of the formal economy. The universe of the small formal business sector comprised all the formal businesses in Soweto operating from demarcated business stands. For inclusion in the sample, businesses had to be independent (not forming part of national or regional chains or franchises) and also had to operate from fixed building structures. The sample was structured to include all independent small businesses operating from shopping malls, smaller shopping centres, industrial areas and stand-alone shops. The lack of a sample frame precluded random sampling. A judgemental approach was applied to ensure the inclusion of all business sectors. The research



instrument was similar to the one used for the informal sector, concentrating primarily on entrepreneurial and business management activities.

It is important to note that the aggregate count as well as constraints experienced in establishing formal and informal businesses in the study area fall outside the scope of this study.

## Methodology

For the purposes of this study, descriptive analysis as well as econometric modelling techniques were used. The descriptive data analysis is aimed at portraying the demographic characteristics of the samples as well as the extent to which various entrepreneurial actions were applied by the two business populations.

The inferential statistical analysis makes use of categorical regression models to facilitate the investigation of predictive relationships in the data. The dependent variable in the case of both the informal and formal businesses is measured in terms of turnover growth and is coded into three categories: businesses that expanded, remained unchanged, or whose turnover contracted. The 12 entrepreneurial-related independent variables used as explanatory variables of the growth experience of businesses are listed in Exhibit 1. These variables are grouped into two categories: operational entrepreneurship that captured the more structured activities such as the construction of plans, and innovative entrepreneurship referring to entrepreneurial ingenuity, spirit and mindset.

Exhibit 1: List and description of independent variables used to quantify the growth experience of informal and formal businesses

Entrepreneurial actions	
Operational entrepreneurship (base conditions)	(i) Compiling a business plan (ii) Updating of business plan (iii) Marketing strategy for business (iv) Risk analysis prior to starting the business (v) Analyses of competitors (vi) Operational plan for business
Innovative entrepreneurship (competitive factors)	(vii) Considering an alternative venture prior to starting the business (viii) Future vision for the business (ix) Regular investigation of other business investments (x) Ease of venturing into a business venture (xi) Not afraid to risk funds in business (xii) Comfortable taking calculated risks

The survival and success of small business has been the subject of a great deal of international analysis (Everett & Watson 1998; Lussier & Pfeifer 200; Cressy 2006). Similarly, in South Africa, detailed studies have been undertaken to analyse growth and development of the small business sector, often with particular focus on informal businesses (Rogerson 2004; Ligthelm 2011). Promoting entrepreneurial spirit increasingly emerges as the key to business success, as entrepreneurship constitutes the thrust behind the establishment and growth of business ventures. Entrepreneurial actions (as independent variables in explaining the growth performance of businesses) embrace both operational actions that can be regarded as important actions for business success as well as innovative actions aimed at enhancing a business's competitive advantages and ultimate growth. The identified actions in Exhibit 1 were assumed as indicators of the entrepreneurial acumen and skills of business owners. Respondents were asked to indicate the extent to which these entrepreneurial actions and orientations were applied in their businesses. The activities were formatted as statements in the questionnaire, and responses were recorded on a five-point scale ranging from 'strongly disagree' to 'strongly agree'.

The independent variables identified in this study are related to entrepreneurial conduct and do not exhaust all the potential factors that influence business growth and sustainability. Notable factors excluded are those related to the macroeconomic environment, and sector-specific issues such as demand and supply conditions prevailing in the various economic sectors of the economy. Cader and Leatherman (2011) found that region (metro, non-metro) and factors specific to the firm (e.g. size, age and type) also affect the survival and growth of businesses. It is important to note that the bulk of the non-entrepreneurial variables that may impact on business performance are fairly homogeneous to both business types. Macroeconomic conditions such as interest rates, competitive pressure within the study area, demand increases due to consumer income growth, and sectoral supply conditions are relevant in this regard. Table 1 confirms that the age and sectoral distribution of the two business panels (formal and informal) are fairly similar. Some variations between the business panels are evident with regard to the educational level of the owner, the status of the business (sole proprietor or close corporation) and average employment size (2.9 for informal businesses and 4.4 for formal businesses) (see Table 1). Due to the large level of homogeneity with regard to the business-specific variables as well as the variables external to the business, it is maintained that entrepreneurial acumen represents one of the major differential factors in business performance in the two business populations.

## Analysis and discussion

### Descriptive analysis

The demographic characteristics of the two business surveys are contained in Table 1. The profiles confirm, inter alia, the following:

- The two business types exhibit similar age structures.
- The educational level of owners is generally higher among formal business owners.
- Informal business owners are younger.
- Both business types are strongly representative of the retail (e.g. grocers and general dealers) and personal service (e.g. phone shops and hair salons) sectors.
- The average employment size in formal businesses is almost double that in informal businesses.
- A substantially larger proportion of informal businesses are established due to the unemployment of owners, while the majority of formal businesses originated from the seizure of opportunities or taking over of a family business. In the GEM terminology, the ratio of opportunity to necessity entrepreneurs was 1:0.8 in the formal sector and 1:3.4 in the informal sector.

**Table 1:** Profile of the formal and informal business panels

Variable	Informal businesses	Formal businesses
(a) Years in operation (%) <ul style="list-style-type: none"> <li>• Less than 3 years</li> <li>• More than 3 years</li> </ul>	32.5 67.5	29.6 70.4
(b) Educational level of owner (%) <ul style="list-style-type: none"> <li>• Primary school</li> <li>• Secondary school</li> <li>• Post-secondary</li> </ul>	32.9 57.6 9.5	12.9 54.8 32.3
(c) Age of owner (%) <ul style="list-style-type: none"> <li>• 30 years or less</li> <li>• 30+ years</li> </ul>	25.4 74.6	14.5 85.5
(d) Status of business (%) <ul style="list-style-type: none"> <li>• Sole proprietor/partnership</li> <li>• CC (close corporation)</li> </ul>	88.9 2.3	68.6 27.9
(e) Sectoral composition (%) <ul style="list-style-type: none"> <li>• Retail grocers/general dealers</li> <li>• Community, social and personal services</li> </ul>	60.5 20.0	76.1 19.2
(f) Average employment (number)	2.9	4.4
(g) Reasons for establishment (%) <ul style="list-style-type: none"> <li>• Unemployed</li> <li>• Seizure of opportunity/family business</li> </ul>	77.5 22.5	45.1 54.9

Table 2 reflects the application of entrepreneurial actions, which can be regarded as indicators of entrepreneurial acumen, by both the formal and informal business owners. The statements distinguish between operational and innovative entrepreneurship. The table shows the mean score as well as the percentage of businesses that agree and strongly agree with the entrepreneurial-related statements in the questionnaires.

**Table 2:** Application of entrepreneurial actions by small informal and small businesses

Variable	Informal businesses		Formal businesses	
	Mean score (out of 5)	% agree/strongly agree	Mean score (out of 5)	% agree/strongly agree
Operational entrepreneurship				
• Compilation of a business plan prior to starting the business	1.88	11.8	3.66	63.2
• Regular update of business plan	1.76	10.1	3.39	56.2
• Marketing strategy for business	2.28	24.0	3.50	56.3
• Conducted a risk analysis prior to starting the business	2.10	21.2	3.48	57.0
• Regular analysis of competitors	2.24	24.5	3.64	59.9
• Compilation of operational plan	2.23	19.7	3.47	57.6
• Average/mean score	2.08	18.6	3.52	58.4
Innovative entrepreneurship				
• Consider alternative investments prior to starting the business	1.99	12.7	3.26	51.6
• Future vision for the business	1.98	24.3	3.62	59.9
• Regularly investigate alternative investments	1.37	18.0	4.43	61.4
• Ease of venturing into a new business	1.41	21.9	3.36	50.6
• Not afraid to risk funds in new business	1.90	11.9	3.36	50.8
• Taking calculated risks not a problem	1.88	12.0	3.30	59.8
• Average/mean score	1.76	17.1	3.39	55.7

The majority of formal businesses confirmed their application of all the entrepreneurial actions. Percentages ranged from 50.6% for ease of venturing into a new business, to 63.2% for compilation of a business plan prior to starting the business. The incidence of informal businesses performing entrepreneurial-related actions was substantially lower, ranging from only 10.1% who updated their business plans to 24.5% who regularly analyse their competitors.

Table 2 reflects the level of applying entrepreneurial actions by mean scores. Based on the following categories, the application of entrepreneurial actions can be aggregated as follows:  $\leq 2.0$  low level of application, 2.1–3.0 medium level and  $> 3.0$  high level (Exhibit 2).

## Confusion about entrepreneurship? Formal versus informal small businesses

Exhibit 2: Application of entrepreneurial actions in formal and informal businesses

	Informal businesses	Formal businesses
Operational entrepreneurship	Medium	High
Innovative entrepreneurship	Low	High

As part of the descriptive statistics, the lifespan data of the panel of 350 informal businesses over the 2007–2011 period are briefly discussed in support of the inferential statistics presented in the next section. Figure 2 shows that just less than two in every five (38.9%) of the businesses were still in operation in 2011. The attrition rate was particularly high in the first year after the opening of the first shopping malls and gradually declined in subsequent years.

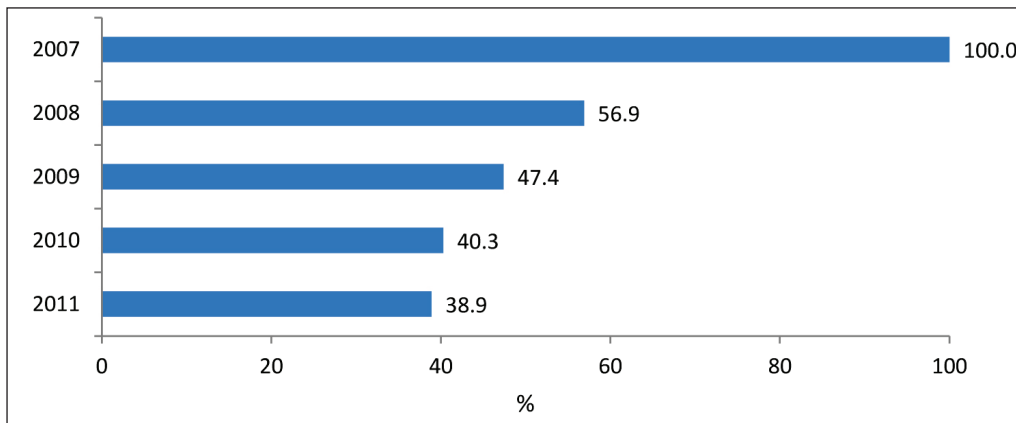


Figure 2: Survival rate of small informal businesses in Soweto, 2007–2011

In addition to revealing a high attrition rate, the longitudinal study also confirmed a lack of growth within the survivalist businesses.

The effect of the high attrition rate on total informal business employment in the study area can be summarised as follows. The closure of 214 of the 350 businesses resulted in a decline of 61.1% in total employment by panel businesses. During this period, an additional 31 new informal businesses were established in the study area, resulting in a net decline of 52.2% in total informal business employment during the 2007–2011 period.

Of more concern, however, was the lack of growth within the survivalist businesses. The average employment size of these businesses remained unchanged at 2.9 employees (full- and part-time employees, including the owner) per business for the entire 2007–2011 period. The lack of internal growth of informal businesses

was also confirmed by financial (turnover) statistics. The percentage of businesses with a meagre turnover exceeding R20 000 (US\$2 000) per month (in real terms) increased marginally from 3.1% in 2007 to 4.6% in 2011. This turnover of the top approximately 5% of informal businesses realised a business profit of approximately R6 000 (US\$600) per month.

The question arises: what factors cause the lack of growth and therefore the survivalist nature of informal businesses in Soweto? This is further explored in the next section.

### Regression analysis

Table 3 shows the regression coefficients calculated for the entrepreneurial variables in the two surveys. The variables included in the informal business survey explain 15.0% of the variance in the dependent variable. In contrast, the variables in the formal business survey explain 31.5% of the variance. This can be considered an indication of the higher level of entrepreneurial acumen and more decisive role played by entrepreneurship in the business performance (growth) of the small formal businesses compared to informal businesses.

The results of the analysis of variance (ANOVA) show that the model variance in the informal business survey is 2.4, while it is 10.9 times more than the error variance in the formal business survey, indicating that the different predictors separately and conjointly succeeded in predicting business growth significantly at a 0.000 level of certainty in both surveys.

The regression coefficients obtained by estimating the full model are also reflected in Table 3. Given that a total of 350 and 650 observations were used in the informal and formal surveys respectively, the fairly large number of entrepreneurial variables can be included in the regression analysis to determine which ones are significant in determining small business growth.

With regard to the informal businesses, the significance levels confirm that the following variables related to operational entrepreneurship contributed significantly to predicting informal business growth: compilation and updating of a business plan, compilation of an operational plan and regular analysis of competitors. Notwithstanding this significant contribution of operational entrepreneurship to informal business growth, Table 2 shows that, on average, less than one in every five informal businesses exercise actions related to operational entrepreneurship. This implies that those applying these actions fared better but constituted a small minority of the informal business population. Because of the relatively low incidence of actions related to operational entrepreneurship among the informal entrepreneurial group,

compilation of a business plan and other plans may be regarded as strong predictors of business success.

A further concern with regard to informal businesses is also evident from Table 3. With the exception of 'having a future vision for the business', none of the innovative entrepreneurial variables affect the growth performance of informal businesses significantly due to their high significance levels. Information in Table 2 provides insight into this phenomenon. Table 2 confirms an extremely low incidence of actions related to innovative entrepreneurship. On average, less than one in every five informal business respondents confirm their application of actions related to innovative entrepreneurship and furthering the competitive advantage and growth of their business.

Regarding the entrepreneurial actions of formal small businesses, Table 3 confirms that not all the operational entrepreneurial actions affect the growth performance significantly due to their relatively high significance levels. Only one factor (compilation of an operational plan) falls between the five and ten per cent level of significance. This factor can be considered as having marginal significance. In explaining these relatively high levels of significance with regard to operational entrepreneurial actions, the incidence of applying these actions by respondent businesses should be considered. Table 2 shows a relatively high incidence in that the majority of formal businesses were involved in action planning including business plans, marketing strategies and operational plans. These relatively high levels of involvement in operational actions resulted in these actions losing their value as differentiators (or their power as explanatory variables) due to respondents adhering to this base condition of well-developed plans and strategies.

Table 3 reflects on the innovative actions performed by formal small business respondents. With the exception of 'the ease of venturing into new businesses', all the other variables are prominent at the five per cent level of significance. These entrepreneurial predictors testify to the willingness of owners to take calculated risks to enhance the competitiveness and growth of businesses. Ultimately this is realised through efficient production and selling of products and services at a higher price than the cost of production to make a profit (Snowdon & Stonehouse 2006).

Table 3 confirms that innovative entrepreneurial actions aimed at enhancing the competitive advantage of a business during its growth and expansion stage reflect the primary differentiator between informal and formal small businesses. Previous studies (Ligthelm 2010) show that other variables of significance in small business growth, which favour the formal business panel, include the size of the business (in terms of employment), its location (in business centres), the skills (educational) level of the owner, and age of the business.

**Table 3:** Regression coefficients indicating which entrepreneurial factors are significant to business growth

Variable	Level of significance (Sig)	
	Informal businesses	Formal businesses
Operational entrepreneurship (base conditions)		
• Compilation of a business plan prior to starting the business	.008*	.434
• Regular update of business plan	.000*	.331
• Marketing strategy for business	.577	.458
• Risk analysis prior to starting the business	.211	.600
• Regular analysis of competitors	.003*	.563
• Compilation of operational plan	.048*	.073
Innovative entrepreneurship (competitive factors)		
• Consider alternative investments prior to starting the business	.704	.012*
• Future vision for the business	.000*	.009*
• Regularly investigate alternative investments	.598	.050*
• Ease of venturing into a new business	.080	.067
• Not afraid to risk funds in new business	.333	.021*
• Taking calculated risks not a problem	.060	.031*
n	350	650
R <sup>2</sup>	0.254	0.346
Adjusted R <sup>2</sup>	0.150	0.315
F-statistic	2.436	10.959
Prov > F	0.000	0.000

\* Denotes a 5% level of significance

## Implications of the study

As indicated earlier in the paper, small business development, particularly entrepreneurship, is directly linked to economic growth. It is also important to note that not all forms of entrepreneurship may be beneficial for private sector development and economic growth. More specifically, entrepreneurship is not only crucial for business formation but also for establishing competitive advantages required for business expansion or growth. The descriptive and regression analyses clearly confirm the higher level of entrepreneurial acumen and more decisive role played by entrepreneurship in the business performance and growth of small formal businesses compared to informal businesses. The analysis also shows that innovative entrepreneurship (related to the ingenuity, spirit and mindset of entrepreneurs) represents the primary differentiator between formal and informal business performance. This conclusion sheds light on the first research question – entrepreneurship largely explains the differential growth performance between the informal and formal business sectors.



The lack of entrepreneurial acumen embedded in small informal businesses largely provides the answer to the second research question. The informal sector cannot be regarded as, and will never become, the springboard of successful and productive business development and growth. Banerjee and Duflo (2011) aptly conclude that “the many businesses of the poor are less a testimony to the entrepreneurial spirit than a symptom of the dramatic failure of the economies in which they live to provide them with something better”. Naude (2008) concludes that the only constructive policy response towards informal survivalist businesses should be to reduce poverty through the creation of jobs in the formal economy. An increase in formal job opportunities therefore sees the informal unproductive sector shrink, not expand. For the most part, the informal sector appears to be a buffer (or safety net) against slipping deeper into poverty.

This reality requires a re-look at the production technology of the informal sector and the role of the informal sector entrepreneurs in the standard theoretical models of the firm. This will be explored in a follow-up paper.

This finding also presents the policy-maker with a challenge. The majority of small business support programmes have followed a blanket approach aimed at supporting all small businesses. There is a growing realisation that policy measures should be more specific and targeted towards small businesses with growth potential. This study makes a contribution in the sense that it quantifies some of the important factors responsible for the growth of small businesses. Apart from demand factors, which are important, it has been found that innovative entrepreneurship emerges as the key predictor of small business sustainability and growth. This entrepreneurial mindset is present in the majority of small formal businesses. At the other end of the scale, a large number of informal microbusinesses in developing societies are only survivalist, and owners enter the business world not by choice but to escape poverty and unemployment. These businesses are unproductive and will remain merely survivalist with limited growth potential.

The formal-to-informal business or entrepreneurship dichotomy creates a useful distinction to inform government policy choices. Small business support strategies, especially in developing countries with limited resources, should be focused on businesses with embedded entrepreneurial acumen and hence the inherent dynamics to create and exploit new innovative economic opportunities. This focused strategy should exclude the bulk of informal businesses that will (in the majority of cases) remain unproductive and survivalist. Indeed, a more textured view of the study populations is required, which may assist in elevating all entrepreneurially endowed business for focused support. The majority of small formal businesses, as well as a small minority of informal businesses, may fall into this category.

## Note

Approval for the publication of this article was granted by Prof. Elmarie Sadler, Deputy Editor of the *Southern African Business Review*.

## References

- Allison, C., Chell, E. & Hayes, J. 2000. 'Intuition and entrepreneurial behaviour', *European Journal of Work and Organizational Psychometrika*, (9).
- Baker, T., Miner, A. & Eesley, D. 2003. 'Improvising firms: bricolage, account giving and improvisational competency in the founding process', *Research Policy*, (32).
- Banerjee, A.V. & Duflo, E. 2011. *Poor Economics: a Radical Rethinking of the Way to Fight Global Poverty*. New York: Public Affairs.
- Baumol, W.J. 1990. 'Entrepreneurship: productive, unproductive, destructive', *Journal of Political Economy*, 98(5).
- Baumol, W.J. 2011. 'Formal microeconomic structure for innovative entrepreneurship theory', *Entrepreneurship Research Journal*, 1(1).
- Berner, E., Gomez, G. & Knorrinda, P. 2008. *Helping a Large Number of People Becoming a Little Less Poor: the Logic of Survival Entrepreneurs*. UNU-WIDER Workshop on Entrepreneurship and Economic Development, Helsinki, Finland.
- Blackburn, R. & Kovalainen, A. 2009. 'Researching small firms and entrepreneurship: past, present and future', *International Journal of Management Reviews*, 11(2).
- Cader, H.A. & Leatherman, J.C. 2011. 'Small business survival and sample selection bias', *Small Business Economics*, 37.
- Chiang, C. & Yan, H. 2011. 'Entrepreneurship, competitive advantages and the growth of the firm: the case of Taiwan's Radio Control Model Corporation', *Journal of Small Business and Entrepreneurship*, 24(4).
- Cressy, R. 2006. 'Why do most firms die young?', *Small Business Economics*, 26(2).
- Everett, J. & Watson, J. 1998. 'Small business failure and external risk factors', *Small Business Economics*, 11(4).
- Frese, M., Krauss, I., Keith, N., Escher, S., Grabarkiewicz, R., Luneng, S.T., Heers, C., Unger, J. & Friedrich, C. 2007. 'Business owners' action planning and its relationship to business success in three African countries', *Journal of Applied Psychology*, 92(6).
- Gartner, W.B. 1988. "Who is an entrepreneur?" is the wrong question', *American Journal of Small Business*, 12.
- Hanks, S., Watson, C., Jansen, E. & Chandler, G. 1993. 'Tightening the life-cycle construct: a taxonomy study of growth stage configurations in high technology organizations'. *Entrepreneurship, Theory and Practice*, 5(29).
- Herrington, M., Kew, J. & Kew, P. 2010. *GEM: Global Entrepreneurship Monitor*. Cape Town: Graduate School of Business, University of Cape Town.

- ILO (International Labour Office). 2002. *Decent Work and the Informal Economy*. Geneva: International Labour Office.
- Kuratko, D.F., Ireland, R.D. & Hornsby, J.S. 2011. 'Improving firm performance through entrepreneurial actions: Acordia's corporate entrepreneurship strategy', *Academy of Management Executive*, 15(4).
- Ligthelm, A.A. 2010. 'Entrepreneurship and small business sustainability', *Southern African Business Review*, 14(3).
- Ligthelm, A.A. 2011. *Small Business Success and Failure in Soweto, 2007–2011*, Research Report No. 412. Pretoria: Unisa, Bureau of Market Research.
- Llewellyn, D.F. & Wilson, K.M. 2003. 'The controversial role of personality traits in entrepreneurial psychology', *Education and Training*, 45(6).
- Lussier, R.N. & Pfeifer, S. 2001. 'Across-national prediction model for young firms', *Journal of Small Business Management*, 39(3).
- Müller, G.F. & Gappisch, L. 2005. 'Personality types of entrepreneurs', *Psychological Reports*, 96.
- Naude, W. 2008. *Entrepreneurship in Economic Development*, Research Paper 2008/20. Helsinki: United Nations University.
- Porter, M.E. 2008. *On Competition: Updated and Expanded Edition*. Boston, MA: Harvard Business School Press.
- Rogerson, C.M. 2004. 'The impact of the South African governments' SMME Programme: a ten year review (1994–2003)', *Development Southern Africa*, 21(5).
- Schneider, F. & Klinglmaier, R. 2004. *Public Policy and the Shadow Economy*. Johannesburg: Chamber of Commerce and Industry South Africa (Chamsa).
- Schramm, C.J. 2004. 'Building entrepreneurial economies', *Foreign Affairs*, 83(4).
- Simrie, M., Herrington, M., Kew, J & Turton, N. 2011. *GEM: Global Entrepreneurship Monitor*. Cape Town: Graduate School of Business, University of Cape Town.
- Singh, R.K., Garg, S.K. & Deshmukh, S.G. 2008. 'Strategy development by SMEs for competitiveness: a review', *Benchmarking*, 15(5).
- Snowdon, B. & Stonehouse, G. 2006. 'Competitiveness in a globalised world: Michael Porter on the macroeconomic foundations of the competitiveness of nations, regions and firms', *Journal of International Business Studies*, 37(2).
- Strom, R. 2011. 'Seeing opportunities in entrepreneurship research: recent data improvements and continuing limitations', *Entrepreneurship Research Journal*, 1(2).
- Tokman, V.E. 2007. *Modernizing the Informal Sector*, DESA Working Paper. New York: UN Department of Economic and Social Affairs.
- Wennekers, S. & Thurik, R. 1999. 'Linking entrepreneurship and economic growth', *Small Business Economics*, 13(1).
- Williams, C.C. 2007. 'Entrepreneurs operating in the informal economy: necessity or opportunity driven?', *Journal of Small Business and Entrepreneurship*, 20(3).
- Zachary, R.K. & Mishra, C.S. 2011. 'The future of entrepreneurship research: calling all researchers', *Entrepreneurship Research Journal*, 1(1).